

ICPS newsletter

Economic Policy for Ukraine: Two Variants for the President

1999 is the year of the presidential elections. Which economic tactics will the acting and newly elected Presidents opt for? It is their choice that the economic development scenarios in 1999-2000 and the political future of the Ukrainian elite depend upon.

Experts from the International Centre for Policy Studies Hlib Vyshlinsky and Serhiy Il'chuk delivered a presentation on possible economic policies and their consequences at the ICPS macroeconomic seminar.

The speakers presented economic policy measures which underlie optimistic and pessimistic scenarios of the development of the Ukrainian economy. According to the ICPS experts, the optimistic scenario requires action in six main directions: (1) state administrative reform; (2) imposition of hard budget constraints for enterprises; (3) budget streamlining; (4) radical tax cuts; (5) lower administrative barriers for businesses; (6) swift and transparent privatisation of large enterprises.

Each of these directions was analysed according to four criteria: (a) its importance; (b) the consequences; (c) who will benefit; (d) who will bear the cost. The results of the preliminary estimate are presented in tables 1-6.

As the ICPS experts explained it, the pessimistic scenario is based on the non-performance of reforms in these very areas: (1) preservation of a Soviet-style state management system; (2) direct and indirect (through tax privileges and mutual cross-settlements) subsidising of nonviable enterprises; (3) failure of the Ministry of Finance to control state finances; (4) soft monetary policy; (5) increase in taxation; (6) implementation of new administrative barriers, and state interference with the markets.

The policy under each of the scenarios will affect different sectors of the economy:

- **Monetary and price stability** the *pessimistic scenario* foresees the possibility of sovereign default at the end of 1999 or beginning of 2000, steep devaluation, emergence of the black foreign currency market and panic inflationary expectations; the *optimistic scenario* anticipates drawing down external loans in amounts sufficient to service the debt, minimum pressure on the hryvnia exchange rate and gradual reduction in exchange rates;
- **Balance of payments** the *pessimistic scenario* will mean a reduction in volumes of external trade primarily due to a fall in exports and depletion of NBU foreign exchange reserves; the *optimistic scenario* will lead to improvements in the balance of payments situation as a result of increased competitiveness of Ukrainian exports and substantial inflow of direct foreign investments;
- **Investments** the *pessimistic scenario* will encompass sharp decreases in investments due to higher risks, higher interest

1. Public administration reform

Why is it necessary?

- the Ukrainian government is directly involved in distributing resources, the government should only be responsible for nailing down general economic rules and regulations, i. e. creating the environment;
- internal organisation of the government in line with existing industries creates incentives for supporting nonviable enterprises;
- governmental decisions do not always comply with the general strategy of the government.

What will it bring?

- state policy will facilitate economic development;
- government decisions will be in line with the general strategy;
- behaviour of government officials will change.

Who will benefit?

- all economic agents through more effective state policy;
- profitable enterprises;
- consumers of state services.

Who will lose?

- state officials in charge of distributing resources;
- directors of nonviable enterprises which can exist only with state support.

2. Introduction of hard budget constraints for enterprises

Why is it necessary?

- inefficient enterprises destroy value;
- debts payable to the budget and wage arrears amass;
- directors receive rent income.

What will it bring?

- economic efficiency will increase;
- the non-payment crisis will be sorted out;
- budget revenues will increase;
- distribution of income will become fair.

Who will benefit?

- in the beginning — most citizens of Ukraine;
- eventually — all the people of Ukraine.

Who will lose?

- directors and their henchmen within the government;
- employees of unprofitable enterprises which will go bust.

3. Streamlining the budget system

Why is it necessary?

- the share of non-earmarked cash revenues of the consolidated budget was 27% in 1998;
- there exists a possibility to finance expenses above the assigned limits;
- the government does not control extra-budgetary funds of government agencies.

What will it bring?

- balanced budget;
- the Ministry of Finance will be able to act more flexibly in servicing the state debt;
- the public will be able to exercise control over budget expenditures;
- restriction of corruption;
- reduction of indebtedness by state agencies.

Who will benefit?

- all of society.

Who will lose?

- those who use state budget funds for personal needs.

4. Substantial tax cuts	
<i>Why is it necessary?</i> Excessive tax burden: • limits aggregate demand, i. e. growth of GDP; • evokes barter; • discourages investments.	<i>What will it bring?</i> • expansion of aggregate demand; • increase in return on investments; • the public will be able to exercise control over budget expenditures; • growth of competitiveness of Ukrainian produced goods; • reduction in prices.
<i>Who will benefit?</i> • the entire community.	<i>Who will lose?</i> • nobody.

5. Elimination of administrative barriers for businesses	
<i>Why is it necessary?</i> • barriers induce unproductive expenses among enterprises and increase the cost of doing business and prices for products; • barriers create grounds for corruption; • barriers impede competition and economic growth.	<i>What will it bring?</i> • use of resources will become more productive, competitiveness of products will increase; • the process of starting enterprises and creating new jobs will become less difficult; • competition will develop, prices will fall.
<i>Who will benefit?</i> • consumers; • entrepreneurs and "would-be entrepreneurs"; • citizens of Ukraine.	<i>Who will lose?</i> • corrupt state officials; • oligarchs who use administrative barriers to protect their monopoly in lucrative markets.

6. Swift privatisation of large enterprises	
<i>Why is it necessary?</i> • the state is not a good owner; • state enterprises require government support; • state enterprises cannot be sued for bankruptcy; • the state does not have investment resources.	<i>What will it bring?</i> • sound corporate governance; • reduced government influence on enterprises; • growth of investments; • increase in employee wages; • additional revenues to the state budget.
<i>Who will benefit?</i> • most employees of former state enterprises; • the budget; • creditors of state enterprises.	<i>Who will lose?</i> • officials of branch ministries; • employees who will temporarily lose their jobs.

Last Week

The International Centre for Policy Studies Goes On-line.

The official web-site of the International Centre for Policy Studies was published on Internet on Friday, 9 April. The web-site can be found at <http://www.icps.kiev.ua>. Among other features are detailed information on the International Centre and its projects, as well as easy and free access to all ICPS publications.

This Week

What Has Ukraine Achieved in the Past Two Years? The ICPS seminar agenda has changed. The macroeconomic seminar to be held at the International Centre for Policy Studies on 13 April will be devoted to the subject "Two Years Past. Reflections on Achievements and Opportunities". The speaker will be Alex Sundakov, who worked as permanent representative of the IMF in Ukraine for three years and now heads the New Zealand Institute of Economic Research. The following questions are planned for discussion:

Next Week

How to Conduct Tax Reform? The macroeconomic seminar at the International Centre for Policy Studies on 20 April will be devoted to the subject "Tax Reform Process". The speaker will be Richard Laliberte, Chief of the Party Fiscal Reform Project, Barents Group.

rates and crowding out of private investments by excessive government consumption; the *optimistic scenario* will mean an increase in aggregate investments due to reduced interest rates, tax cuts and reasonable policy on capital allowances and increase in direct foreign investment inflow;

• **Economic growth** the *pessimistic scenario* will result in abruptly dissolved business activity (decline of real GDP by 5% and 6% in 1999 and 2000 respectively) from wide spread barter and non-payments, reduction of output from industries producing goods for the domestic market and especially a sharp fall in agricultural production; the *optimistic scenario* aims to make the structure of the Ukrainian economy healthier: decrease in heavy industries and growth in the light and food processing industries and in agriculture will lay the foundation for the recovery of GDP growth as early as 2000;

• **Welfare** different reactions from the economy toward various economic policies will influence the welfare of the people: under the *pessimistic scenario* wage arrears will grow, the average income will decline due to increased unemployment and part-time employment, income will decrease in real terms due to rapid price inflation; under the *optimistic scenario*, real household income will start to grow in 2000 as a result of GDP expansion, social debts will decrease and income from entrepreneurial activities will increase.

Comments Made at the Seminar

Volodymyr Lanovyi, Advisor to the President of Ukraine on Economic Policy:

One of the objectives of economic policy should be to stabilise corporate finances. A mechanism of transferring property should be implemented: privatisation cannot have only the aims of increasing budget revenues and maximising the amount of initial investment into the enterprise.

Another objective should be to redistribute government attention toward private businesses from non-competitive heavy industries.

The election of a left-wing candidate at the presidential elections will mean a weaker government, growing power at local Radas, and disintegration of Ukrainian economic policy as local authorities defend markets and producers within their jurisdiction from competition.

Olexii Sekarev, UEPLAC Economist:

I think the Ukrainian government has already perceived the necessity for hard budget constraints among enterprises, the main reason for this conclusion being the crisis of state finances. So one can expect certain developments in this direction already this year. We may also see some fiscal streamlining measures and tax cuts. Though administrative reforms and the elimination of administrative barriers for business are unlikely to start this year.

Macroeconomic seminar "Presidential Elections — Possible Outcomes for the Economy in 1999 and 2000", International Centre for Policy Studies, 6 April 1999. Speakers: Hlib Vyshlinsky, ICPS Publications Director and Serhiy Il'chuk, Head of the Quarterly Predictions team

ICPS Newsletter is a weekly publication of the International Centre for Policy Studies delivered by electronic mail.

To be included into the distribution list mail to: marketing@icps.kiev.ua.

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